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**NONPROFIT ORGANISATIONS AND
VALUE ADDED (GST) TAXATION**

**WORKING PAPER NO. 26
OLE GJEMS-ONSTAD¹**

**PROGRAM ON NONPROFIT CORPORATIONS
QUEENSLAND UNIVERSITY OF TECHNOLOGY
BRISBANE**

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1. NON-PROFIT, BUT NOT TAX-EXEMPT?

1.1 A net income tax presupposes profit

The subject of this paper is the changes in the taxation of non-profit organisations which seem to be more or less inherent in the value added taxes. The Australian federal Coalition's proposed goods and services tax will be part of the discussion.

In many countries the terms non-profit organisation (NPO) and tax-exempt organisations have been close to synonyms. The term taxes have in many respects been understood as income taxes, i.e. direct taxes. Governments in developed countries are at present, however, typically relying on indirect taxation as their main sources of revenue; especially value added taxes (VAT) and payroll taxes. (TEI 1992 p. 84 and 92).

The income tax is traditionally a net income tax. It relates primarily to tax subjects engaging in activities for profit and actually resulting in a profit. It is a "profit tax"; therefore, no profit - no tax.

Non-profit organisations are, of course, not taxed under a net income tax as long as they do not have any net income; or any income for which there might be special tax provisions. The question of taxation has usually arisen when some or all of the activities of the organisation has resulted in some profit. At this point, the theory and practice of net income taxation varies. There is no universally accepted theory of how profits of charities etc. should be dealt with under the net income taxes.² This lack of commonly held conclusions should, however, not preclude the simple observation that the net income tax presupposes a profit. Therefore, a typical NPO will not be within the main focus of a net income tax.

1.2 VAT taxes supplies of goods and services, not profits

The perspective of the value added tax is quite different. The consumption style value added tax, which is the common form of VAT,³ is not a tax primarily relating to subjects, but to transactions,⁴ to the supply of services and goods. The objects are the main focus. The basic questions of the VAT are therefore related to the transactions: Has there been a supply of goods or services for a consideration; not whether there was any profit motive or profit as end result. Profit is not a necessary test for taxable activities under the VAT (Tait 1988 p. 36). Profit is not a prerequisite to tax liability, since profit is

2 See e.g. the instructive survey of the theories of the taxation of NPOs in the US literature by Simon 1987.

3 The different forms of theoretically possible VAT may be divided into three main categories: Gross-product VAT where capital equipment purchases may not be deducted resulting in a distortive "pyramiding" tax; income-type VAT where depreciation on capital goods is allowed as a deduction; and consumption-style VAT where all investment is deducted. (TEI 1992 p. 5-6).

4 It may also, correctly, be said that the income tax is "a tax on transactions" (Chirelstein 1988 p. 70). But this is to point out that the income tax ordinarily depends upon the realization principle and does not tax unrealized income. Therefore, the income tax is not "a tax on income in the economic sense" (ibid.).

only a small element of the tax base. (TEI 1992 p. 7). The Coalition's proposed GST is based on the same assumptions: "A taxable activity is an activity carried on continuously or regularly whether or not for profit." (Fightback Supplementary Paper No. 5 1991 p. 5).

In one respect the value added tax represents gross, not net, taxation. The value added tax presupposes a netting of output and input tax under the common credit-subtractive-method for calculating the tax liability (see *infra*) which is also proposed for Australia by the Coalition. Therefore, it may, in one respect, be said to be a net tax.⁵ Nevertheless, it is not a precondition to have a net income or profit to be subject to the tax.

1.3 Different tax bills

The amount of taxes to be paid, and therefore the importance of the tax, may also differ considerably between an income tax and a VAT as the decisive criteria of VAT are not the end result, but the turnover.

Applying an approximation of the figures in a Norwegian Supreme Court decision (Rt. 1985 p. 917), a non-profit correspondence school may have a net result of 200,000. The potential income tax bill may be 80,000 with an income tax of 40 pct. Of course, as an annual amount this adds up. Compared to the potential impact of the VAT, one might however state that the disputed income tax is small change. The total sales were 50,000,000; applying a 15 pct. VAT the output tax might be 7,500,000. The ratio of income tax to output VAT would be approx. 8:750, or 1.1 pct. If the correspondence school had shown a net loss in its accounts for the year in question, the difference might have been infinite. These numbers will of course vary according to how large the profit is compared to total sales. The output tax is not a final tax bill as the input tax may be deducted (see section 3). And the net VAT may be borne by the students, not the school, through the incidence of the tax. Nevertheless, the numbers indicate that the question of NPOs and VAT are not trivial or insignificant, even though they may seem technical.

1.4 The government and the third sector

As the VAT is a relatively new tax, it seems like many representatives of NPOs only recently have woken up to the important change in the tax environment and the potential tax bill for these organisations.⁶

In parts of the literature on NPOs the term the third sector has been applied (e.g. Douglas 1983 and Filer Commission 1975). It points to the position held by many commentators that NPOs should be

5 Melz 1990 argues that the similarities among the income tax and value added tax are greater than formerly accepted. In my view, this position does not hold, especially taking NPOs into account.

6 See e.g. the unpublished report of the conference VAT and Charities in the European Community, Brussels October 20/21 sponsored by the Charities' Tax Reform Group.

seen as different from and independent of the government (and commercial organisations). At the end of the day, a discussion of VAT is not a matter only of money; it touches the basic relationship between the government and the NPOs in a modern society.

2. NOT EQUITY, BUT EFFICIENCY

2.1 Income tax: An instrument for justice

The difference between a subject-related income tax and an object-centered VAT also results in a shift regarding the relevant tax policy considerations. The income tax reforms around the world in the late eighties and early nineties, being inspired by the US Tax Reform Act 1986, are to a certain extent products of disillusionment with the results of direct taxation.

High progressive tax rates and all kinds of deductions, special provisions, exemptions etc. should give a more just society, redistribute income and offer incentives for future-oriented businesses and regions left behind. Even though there is a shift from equity to efficiency considerations in income tax policy, the abolition of the income tax would in many countries be unacceptable. This is not simply because it might result in revenue problems for the government. The income tax is still by many regarded as a necessary instrument to avoid a further widening of the economic differences between "rich" and "poor". The income tax does not only provide the government with money to buy justice; it has in itself been understood as an instrument for justice. Under the income tax, it is therefore an inherent and valid question whether it is just or equitable to tax the subject in question.

2.2 VAT: A more efficient way to finance justice

The value added tax as such is not motivated by equity or redistributive considerations. With a term often applied, the VAT is a "money machine" with a huge revenue potential at low administrative costs. In many countries the administrative costs of the VAT has been estimated at half the costs of the income tax.⁷ Justice is not the basic motive for the VAT as such. In no country has the VAT been introduced to get more justice through its own mechanism. On the contrary, as any general consumption tax, the VAT has a potential regressive effect as the ratio of saving to consumption may be higher in high-income brackets. This potential injustice has been accepted on the ground that the money supplied by the VAT may be used to correct the injustice and "buy more justice".⁸ The VAT itself, however, does not provide it (unless one compares the VAT with with more unfair taxes).⁹

7 See the different studies referred to by TEI 1992 p. 16-17 where e.g. in Europe the average cost of administering the income tax has been estimated at two per cent while the VAT administrative costs in some countries (with high VAT rates) have been as low as 0.32 per cent. The estimates are not totally reliable, and the results differ between countries. In the US, a study by the Treasury in 1984 of the administrative costs of a proposed VAT ended up with 0.97 per cent of revenue, while the actual administrative costs of the federal income tax has been estimated at 0.48 per cent.

8 Fightback 1991 chapter 10 outlines compensation schemes for the new proposed Australian GST.

9 Fightback 1991 p. 47-56 argues why the proposed VAT is more just than the present Australian Wholesale Sales Tax.

Therefore, equity considerations are not part of the inherent or basic premises of a VAT. It is more a subsidiary point of view; of correcting or adjusting the negative effects flowing from a general sales tax.

Supposedly, no country has to date repealed its income tax system upon introducing a VAT. The common position seems to be that an income tax as a suitable instrument of equity may be needed to balance the regressivity of the VAT (TEI 1992 p. 130).

Under the VAT, the focus is on efficiency and how to avoid that all kinds of special considerations including justice, social causes etc. may hamper the revenue raising job.

2.3 The more general, the more efficient

In the literature on VAT, the tendency is quite clear: The VAT is a general sales tax and should, as such, be as general as possible. Any exclusions and special provisions are not a way of fine-tuning an instrument for equity, but a potential way of endangering an important revenue raising instrument.

With some of the concluding remarks of a leading commentator: "Adopt a VAT with as wide a basis as is practical and resist arguments for special cases and exemptions." (Tait 1988 p. 399). In the same line of reasoning Peter Barrand, Director of Inland Revenue Department, New Zealand, is explaining why the New Zealand's GST "is seen as a model by other countries". One of the four key features was "a strong commitment by the Government to the introduction of a simple efficient tax (with a single rate, no exemptions, no zero-rating and no complex rules)" (Barrand 1991 p. 2). The Coalition also emphasises that the GST "should be as comprehensive as possible" (Fightback 1991 p. 65).

2.4 Equity means taxation?

The arguments may run opposite to what one has been used to under the income tax. In a discussion of the income tax and NPOs, an equity inspired way of reasoning may be: If an organisation is not run for profit, why should it be taxed in the same way as institutions with a profit motive? In relation to the VAT, it is more often pointed out that it will result in inefficiency and market distortions between different suppliers if the same - viewed from the "outside" or just objectively - transactions are taxed differently.

Of course, also in income tax policy discussions, and recently more so, efficiency, neutrality and market considerations are important. Similarly, under the VAT social policy considerations are valid. However, the direct and indirect taxes are different. Anyone approaching the VAT on behalf of NPOs loaded with the same kinds of arguments as has been used in favor of tax concessions under the income tax may too late find that she speaks an outdated language to which no - or only a few - policy makers really pay much attention. For scholars interested in NPOs and taxation, it may be especially important to avoid arguing in an "idealistic" or "principled" way where the reasoning deviates from the accepted "mainstream" premises in the field. Then, one has to understand the basic structure of the

VAT.

3. AUSTRALIA: VALUE ADDED TAX 1 OCTOBER 1994?

In Australia, the Opposition (the Coalition: The Liberal and National Parties) has proposed to introduce a Goods and Services Tax (GST) on 1 October 1994. The GST bears the same name as the similar tax systems recently introduced in New Zealand (1986) and Canada (1991).

Technically, the proposed GST is a value added tax of the consumption type well known from the European Economic Community (EEC) where it is mandatory for the 12 member states to implement a general sales tax system according to this VAT model.¹⁰ The VAT has been proposed in the tax literature since at least 1919.¹¹ The idea has first caught on during the last decades, but has then become widely popular. At present, 21 out of 24 OECD countries have adopted a value added tax system (Fightback 1991 p. 68).

In the United States, a federal VAT has been debated extensively. From 1980 at least seven proposals for different kinds of VAT have been put before Congress (TEI 1992 p. 117-26). A common feature of these proposals have been some sort of exclusions for qualified NPOs - so-called section 501(c)(3) organisations. Congress has, however, so far not been willing to introduce any VAT in the US.

Originally, the Australian GST was envisaged as a single rate VAT (Fightback 1991 p. 65). Later, the Coalition seems to have accepted to remove basic foods from the GST (The Weekend Australian December 19-20 1992) and may be moving towards a multiple rate VAT.

The Australian GST will be based on the traditional dichotomy in VAT: A subject is either a taxable person or a consumer. The taxable persons are liable to charge the GST on their supplies to outsiders and pay this output tax on to the government. First, however, all tax on goods and services acquired by the taxable person, the input tax, may be deducted. Under the proposed credit-subtractive method (the credit method),¹² each taxable person only pays the net sum after having subtracted the input tax from her output tax.

10 The European Economic Community was established in 1957 with six member countries; at present (January 1993) there are twelve members (total population 345 million) and five applicants. All member states have to introduce a value added tax system which is to a large extent harmonized through the relevant EC VAT Directives. The Sixth Directive is the most important (77/388/EEC). Of the six recent directives adopted in 1992, most attention should perhaps be paid to the directive dealing with the new minimum rate of 15 pct. and the allowed two reduced rates of not less than 5 pct. (92/77/EEC). Taxation, and consequently VAT, is not part of the Agreement on a European Economic Area (EEA) entered into in 1991 between the twelve EC member states and the seven (six) EFTA states (not yet ratified and in force - and rejected by a Swiss referendum in December 1992).

11 Terra and Kajus 1991 p. 35 with references to the works by the German Wilhelm von Siemens in 1917 and the American Thomas S. Adams in 1921.

12 Under a consumption-style VAT, the tax liability may be calculated according to the addition method, the sales-subtractive method and the most common form, the credit-subtractive method - often simply called the credit method (TEI 1992 p. 6-7, 10).

Persons who are not taxable under the VAT, are consumers. This concept encompasses not only ordinary physical persons, but all organisations etc. who do not supply taxable goods and services. Such institutions will have no obligation to charge any outgoing VAT on the supplies they make. However, they will not be able to obtain any refund for ingoing VAT.

4. NPOS, EXEMPTIONS AND ZERO-RATING

4.1 Limited theoretical discussion of NPOs and VAT

The VAT being a relatively new tax, the international academic literature is limited but growing as the VAT at present may seem to be the most potent revenue raising instrument with considerably less distorting side-effects than the income tax. The theoretical discussion of NPOs under the VAT has been even more limited. There does not seem to be any consistent and widely accepted theory on the subject - apart from the simple position already referred to that the VAT should be as general as possible with as few exceptions as possible. (Tait 1988 p. 49-79).

Under tax expenditure analysis, also the VAT and NPOs have been discussed (McDaniel and Surrey 1985 p. 92-93). Their conclusions, however, may be criticised as their definitions of the basic concepts as consumption are not sufficiently precise. (Gjems-Onstad 1990).

4.2 What is an NPO

Most, if not all, income tax laws will provide some definition of NPOs or charities.¹³ It does not, however, seem to be any universal acceptance of the criteria that should be part of the definition.¹⁴ In the Anglo-American-Australian tradition there is a distinction between charities and other NPOs which is not always adhered to in other countries. But many countries seem to reflect some of the same kind of differentiation between "hard-core" NPOs and less idealistic or less humanitarian NPOs.

To agree on a definite and universal definition does not, however, seem to be a prerequisite for the discussion. In law, there is always the problem of "drawing the line" which relates to the dichotomous way of legal thinking in a basically continuous universe. Referring to - and supplementing - the criteria adopted by the Royal Norwegian Commission on Voluntary Organisations in 1988 (NOU 1988:17), we are discussing the VAT treatment of institutions with some or all of the following characteristics:

- private persons have joined together to realise some goals, projects or ideas,
- activities initiated by private persons, and not by public authorities,

13 For Australia, see e.g. Ernst and Young *in* McGregor- Lowndes 1992.

14 Even after the extensive debate in the US, no such commonly accepted theoretical definition has been agreed upon (Simon 1987).

- the leadership may be on a private and voluntary basis,
- the main purpose is not profit-making,
- some or all of the activities may be based on unpaid (voluntary) work from members and sympathisers,
- part or most of the income may come from voluntary contributions.

4.3 Indirect exemptions, exemptions and zero-rating

VAT may affect NPOs in basically two ways: Through input taxes and through output taxes.

If an organisation is exempted from income taxes, it does not (necessarily) file an income tax return and it does not pay taxes.

Under VAT an exempt organisation does not file VAT returns. Neither does it charge any tax on its supplies to clients etc. nor pay the government any output taxes. Being exempt means being outside the VAT-system; therefore the input VAT which is paid may not be lifted. The organisation is taxed - indirectly through an increased price to the suppliers from where the organisation buys goods and services.

An exempt organisation under the VAT is not tax-free. It is treated as any other consumer. How high the effective tax will be, depends on the relative portion of the organisation's costs which relate to taxable supplies. The more of the costs which relate to e.g. wages (which are free of ingoing VAT¹⁵), the less the proportion of VAT actually paid. In the same way, the more of the financing of the organisation's activities which takes place through (tax free) donations of goods and services, the less the relevance of any input tax. In such situations, the status as tax exempt may resemble the position as tax-free.

In the EC countries the present concern of charities in relation to VAT seems for a large part to relate to the input tax.¹⁶

Status as tax exempt may also result in cascading or double (in theory triple etc.) taxation. If an exempt organisation supplies goods and services to taxable persons, there will not be any formal input tax to be deducted. The input tax paid by the exempt organisation has been "hidden", and is therefore no longer deductible when the goods or services again enters the VAT-chain of taxable persons.

A seemingly paradox of the VAT is that status as a fully tax-free organisation may only be obtained through being a taxable person and part of the formal VAT system and filing VAT returns. "Zero-rating" is the concept which allows an effective tax free status under VAT: The organisation pays input

15 Under the addition method of calculating the tax liability under a consumption-style VAT, wages paid are included in the tax base in calculating the outgoing VAT (TEI 1992 p. 6). But VAT is not incurred as an input tax on wages.

16 See e.g. the unpublished report of the conference VAT and Charities in the European Community, Brussels October 20/21 sponsored by the Charities' Tax Reform Group.

tax, but will have this refunded as any other taxable person. The output tax is not charged - the supplies made by the organisation are zero-rated - and therefore the organisation's input tax will be equal to its credit charge against the tax office. Summing up: "Exemptions may be used to remove certain types of industries from the system and zero-rating may be used to remove all tax from a good or service." (TEI 1992). A term that may include both categories is "exclusions".

A reduced rate within a multiple rate VAT may also result in less effective tax being paid than under the status as tax exempt. In numbers: An organisation buys taxable goods and services for 115. With a VAT-rate of 15 pct., computed on the tax-exclusive basis (as proposed by the Australian Coalition and common in present VAT-systems around the world), the VAT is 15. If the organisation furnishes goods and services of less than 300, it will be better served by being obliged to charge an output tax of 5 pct. ($300 \times 0,05 = 15$) than being tax exempt. (Compliance costs not taken into consideration.)

NPOs may be exempted or zero-rated directly through provisions exclusively dealing with such entities. However, they may also be exempted or wholly or partly zero-rated through VAT rules which are not directly related to NPOs, but which may be of great practical significance to important parts of the NPO-sector. To emphasise that these exclusions are not directly or primarily related to the institution as such one may use the terms indirect exemption and zero-rating. As the VAT basically is object-oriented, the most important exclusions may often be those that are not directly or primarily oriented towards the characteristics of the institution.

The Coalition's proposal has chosen some sort of middleway. (Fightback Supplementary Paper No. 5 1991 p. 12-15 and 23-25).

Some services are excluded. Health services are to be zero-rated when supplied by qualified professionals. NPOs will be included; but apparently so will also for-profit hospitals etc. Educational services will be zero-rated if leading to a degree, diploma or trade certificate and offered by certain kinds of institutions which are later to be qualified. Again, no explicit reference is made to any status as NPO as a prerequisite for zero-rating. Other courses of instructions than those leading up to diplomas etc. will be taxed. Again, it does not seem to matter whether the sports instruction is offered by a NPO or an academy run as an ordinary business.

On the other hand, charities and religious institutions are to be zero-rated on the basis of their status as such, irrespective of the services offered - as long as they disqualify the institution as a charity or compete directly with the services supplied by ordinary businesses.

The next section discusses on a more general basis the criteria for zero-rating or exempting certain services from VAT. After having dealt with different aspects of what may be called indirect exclusions, and some other more technical questions, section 5-7 will deal with direct exemptions and zero-ratings in section 8.

5. INDIRECT EXEMPTIONS AND ZERO-RATINGS

5.1 What services are taxed

No VAT system in any country neither is nor has been exhaustive in scope. (TEI 1992 p. 10).

The common tendency of modern VAT systems is that goods are taxed on a more general basis than services. As many NPOs render services, it will often be of great importance to them where the line is drawn between taxable and non-taxable services.

Financial services are usually left outside the system; i.e. exempt. It is difficult to calculate the tax that financial intermediaries should pay. However, this exemption is typically of no great significance to traditional NPOs.

Most countries leave educational and medical services outside the VAT. The same applies to research performed on the basis of grants. These exclusions may be very important to a considerable part of the "third" sector. Many NPOs also offer different sorts of counseling, personal guidance etc. NPOs may furthermore be involved in various types of entertainment, sports-events etc. In the European Community, each member state may exempt such services¹⁷. They may also, under some quite complex rules, uphold (but not introduce) not only exemptions, but zero-rating for such services.¹⁸

There is no commonly accepted theory which may be applied to draw an "objective" line between taxable and non-taxable services. In the various VAT systems around the world, "myriad items are exempted from tax" (TEI 1992 p. 12). Each country in the world implementing a VAT system, has adopted unique ways to adapt the tax to its political, economic and social milieus. (TEI 1992 p. 10). Within the EC, the concessions made possible by the Sixth VAT Directive have been characterised as "extremely flexible" and "complex". Probably, without such a flexibility, the EC countries would not have been willing to introduce a harmonised VAT system. (Terra and Kajus 1991 p. 578).

Above, I have referred to the commonly held position that the VAT should be as general as possible and include all kinds of consumption. A balancing point of view may be that the VAT should only be introduced for expenditures which resemble what one ordinarily will understand as consumption. The problem is, however, that the concept of consumption is unclear and may be stretched far beyond everyday language to include anything that a person or business uses (destroys, deteriorates, transforms). (TEI 1992 p. 9). In the EC legislation regarding the possibility to continue with zero-rating, the criteria "clearly defined social reasons" is applied.¹⁹ This criteria is pragmatic and subjective and hard to inject with a theoretical dimension.

17 Sixth Directive, art. 13.

18 Sixth VAT Directive (77/388/EEC) art. 28 (2), cf Second VAT Directive (67/228/EC) art. 17 last indent.

19 Second VAT Directive (67/228/EEC) art. 17 last indent.

An alternative position is to regard the VAT as a pragmatic, revenue-motivated tax. Services which it may seem impossible to define or estimate clearly, should not be taxed. This line of reasoning typically will conclude that financial services should not be taxed. On the other, hand, to leave some services untaxed may create market distortions because they may be used as substitutes for taxable services. A large proportion non-taxable services may reduce the total basis for the VAT, and thereby its revenue potential unless the tax rates are increased. Most non-taxable services and added distinctions will increase the costs of tax administration.

For any service to remain untaxed, it should be pointed out that the revenue potential is small (e.g. most of the services are rendered free, see below), that the administrative costs are low because the distinction is easy to practice, that the prospects of market distortions are relatively insignificant, and that there are clear social etc. reasons to exclude the services. The extent to which these criteria are satisfied, will vary from country to country because they to a large extent depend on practical circumstances, not theory.

Concerning education, representatives of NPOs might feel inclined to point to the fact that this is investing in future abilities, not consumption. This way of arguing may, however, beg the question. The concept of consumption is so unclear, that any legislator may feel quite free to apply the circular definition that consumption is the services which her VAT-legislation defines as taxable.

Health services and education aimed at public exams and proficiency certificates, will probably be the clearest candidates for non-taxable services of especially relevance to NPOs. Although the Coalition's proposal does not directly favor NPOs, indirectly many NPOs will benefit from these provisions for health and education.

For cultural activities and entertainment, on the other hand, it may often be hard to see how the line should be drawn. The Coalition seems to have taken the position that consequently those services should be taxed. In its Technical Manual, Supplementary Paper No. 5 1991, on the VAT, the Coalition does not however, have any section on cultural activities as such. The conclusion appears to be that they are to be taxed if they do not qualify as educational services (or health services, e.g. psychotherapy) or are rendered by charities or religious organisations.

5.2 Exemption or zero-rating?

The legislator has to choose between exemption and zero-rating for the services which are to avoid the VAT.

For NPOs zero-rating undoubtedly lowers the tax bill since this is the only method to effectively remove all input tax. The compliance costs of the organisations and the administrative costs of the tax administration will usually be higher with zero-rating.

For services outside the VAT system, the legislator, as proposed for Australia, may make zero-rating

available only to certain institutions.

An exempt NPO simply does not file any VAT returns etc. Just like any ordinary citizen and any other "VAT-consumer", it has no paperwork, no accounting requirements etc. in connection with the VAT. For many organisations more reliable accounting procedures etc. may increase the efficiency of its work - and not only help it file VAT returns in a proper manner. It may, however, be quite expensive and difficult for organisations partly relying on voluntary work etc. to fulfil such requirements. For some institutions it may change some of the "atmosphere" of its work.

Although the tax bill gets reduced, some NPOs may be better off as tax exempt than as zero-rated institutions. In this paper, the VAT is seen as a pragmatic, not an ideological tax. In such a perspective, it may be possible to allow the institutions supplying services which are to be zero-rated, to elect for status as tax exempt instead. Such a provision does not seem to be part of the Coalition's proposal. As long as this election is binding for some years, it should not cause any substantial administrative problems to the tax administration; and clearly not to the NPOs. Organisations with an annual turnover below the registration threshold will already have this election.

5.3 Australia: GST as educational policy?

In an international perspective, the Coalition's choice of zero-rating health and educational service may seem quite liberal. Apparently, it has been decisive for the Coalition that private organisations should not face a significant tax burden compared to government institutions (Fightback 1991 p. 74-75. Government institutions, however, under many VAT-systems will have to pay input tax. It is not absolutely necessary to zero-rate private institutions to treat them like government institutions. Out of 26 countries listed by Tait 1988 p. 52, 24 exempted medical services, but they were zero-rated by none. Regarding educational services, 25 countries²⁰ would exempt them, but zero-rating was not available in any country according to this list.

On the other hand, the Coalition is drawing a rather strict line regarding what may be called zero-rated educational services. Under the proposed GST, it may be very important for the educational institution whether its services qualify or not. Choosing zero-rating means drawing a very important economic line between institutions, both NPOs and ordinary businesses, supplying exam-related educational services and other educational services. Through its GST proposal the Coalition may introduce a distinction which has stronger policy implications for education and training than is reflected in the documents presented in Fightback 1991.

If the qualification as a school awarding diplomas etc. depends on public authorisations, the relative economic value of these authorisations will increase. So will the dependency on the authorities handing them out. Also, the public bodies authorising different kinds of schools indirectly will decide tax questions of possibly great significance to the schools involved. If the procedural requirements for

20 Norway appears to tax educational services according to Tait's list; they are, however, exempt.

these authorities differ from the administrative procedures of the tax authorities, some questions of principle may arise.

6. NPOS AND SMBS: THE TAXATION THRESHOLD AND SIMPLIFICATION SCHEMES - INDIRECT EXEMPTIONS

6.1 Costs of VAT decrease with increased size

Many NPOs are small. For the introduction of a VAT with its potentially substantial and often heavily sanctioned filing requirements not to interfere too much with NPOs, it may be of importance to look into the thresholds for registration and the possibility of flexible filing requirements. As simplification schemes may be connected to thresholds for turnover, these conditions should be considered together.

The compliance costs of VAT will vary. In relation to turnover they will typically decrease as the turnover increases. (IFA 1989 b p. 31). Most countries are aware of the often repeated saying that increased employment is dependent on small and medium sized businesses (SMB). Compared to big business corporations the VAT may be seen as (compliance) surcharge tax on SMBs.

6.2 Low registration thresholds - negative net revenue?

Any VAT system has to have some kind of registration threshold. Entities which are not qualifying for registration will be exempt - paying input VAT without any deduction and having no obligation to charge an output tax.

In the EC the harmonised, but not mandatory, threshold has been ECU5,000 (approx. AUS \$8,000), art. 24(2)(a) (77/388/EEC). It is easily demonstrated that with such a turnover the costs of administration and compliance usually will be much higher than the tax paid. With a VAT of 15 pct. the output tax will be $\$8,000 \times 0.15 = \$1,200$ - before the input tax is deducted. The costs of compliance and administration may possibly exceed such an amount. For Australia, a threshold of \$30,000 has been proposed; the maximum tax to pay for the costs will be \$4,500. Net tax revenue after deductions for input tax and estimated compliance and administrative costs may be insignificant - perhaps negative. Of recently introduced VATs, Canada has a threshold of CAN \$30,000 and New Zealand \$30,000 as of 1 October 1991.

The legislator probably will be motivated by the need not to put unnecessary burdens on small and medium sized businesses when setting the registration threshold. When there is no special threshold for NPOs, the exemption that follows from the registration threshold will be an indirect exemption.

6.3 Alternative registration thresholds for NPOs?

In some countries, e.g. Norway, there is a substantial difference between the general registration threshold and an alternative threshold for NPOs (NOK 30,000 [approx. AUS \$6,000] vs. NOK 70,000

[AUS \$14,000]). Again, there is no theoretical reason why an alternative threshold should not be adopted. The general threshold is built on purely pragmatic reasons. Any differentiation of thresholds will, of course, result in increased administrative costs for the tax authorities. An alternative threshold for NPOs has to be justified with the same rationales which have motivated the threshold for SMBs: The costs of compliance and administration will not be in proportion to the net taxes paid. For small NPOs the costs may be substantially higher because they are not run according to ordinary business principles. Their size may be small on a more permanent basis. Many SMBs with a turnover near thresholds like \$30,000 may typically be in some kind of start-up position.

For NPOs an additional argument may be lodged: Parts of the third sector have as part of their functions in society to help people internalise moral and legal behavior. Legislation which is not sufficiently adjusted to the costs of compliance, may tempt such organisations into unlawful behavior. Then they start making their own thresholds which are more realistically adjusted to the actual costs of respecting the law.

For Australia, the proposed general registration threshold of \$30,000 may seem high enough not to justify the additional administrative costs of an extra threshold for NPOs. However, one might ask the question whether such an increased threshold might be appropriate when charities and religious organisations are to be taxed when they "compete directly with businesses in the community" (Fightback Supplementary Paper No. 5 1991 p. 24). An increased threshold would make it unnecessary to draw what may be an unclear and difficult line when the amounts in question are relatively insignificant.

6.4 Branches and divisions

Regional and national NPOs may have branches in different locations. In practice, therefore, it may be quite important how the entity is defined in relation to the registration thresholds.

In New Zealand, "the criteria to be applied to determine whether a non-profit body can split its taxable activity into branches or divisions are:

- (1) the non-profit body must be carrying on a taxable activity;
- (2) an independent accounting system must be maintained by each branch;
- (3) each branch must be separately identified by reference to the nature of its activities or its geographical location" (Barrand 1991 p. 8). As long as such requirements are interpreted somewhat flexibly, they may render NPOs a possibility to stay out of the VAT system even though their total regional or national turnover may be substantially higher than the general threshold of e.g. \$30,000.

Also in Canada, one of the requirements for branches of NPOs and charities to qualify as separate persons in relation to the registration threshold, is that they keep separate accounting records. One may, however, question why the accounting systems have been maintained separately. If such paper

work is centralised, maybe to reduce costs and secure a proper book keeping standard, the interests of the tax authorities should be satisfied as long as it is clear that the activities are going on in different geographical locations.

The Coalition's proposal does not seem to distinguish between the taxation of branches of NPOs vs. the formal and total organisation as such.

In practice, the registration thresholds and rules for identifying branches may be important. Before a new VAT is introduced, organisations or working parties representing NPOs may have much to gain in identifying what kinds of thresholds and definitions of branches that may help small NPOs to stay outside the VAT system. Empirical documentation as to the number of organisations and branches involved, should be of great interest to the legislator when she is about to draw in more detail a line which is purely pragmatically motivated.

6.5 Simplification schemes

Under most VAT systems taxable persons will obtain a credit because they are charging an output tax which they do not immediately have to transmit to the tax office. Frequent filing terms will limit this credit period. Often, the taxpayer has to file every second month which is proposed as the standard taxing period for Australia (Fightback Supplementary Paper No. 5 1991 p. 6).

Taxable persons who are zero-rated or for other reasons regularly show a negative net tax may want a shorter taxable period to obtain their refunds more frequently. VAT legislation will often make such an election possible, which may be of interest to professionally organised NPOs within zero-rated service industries. The Coalition's proposal state that "any person may apply to the Taxation Office to be allocated a one month taxable period" (Fightback Supplementary Paper No. 5 1991 p. 8).

NPOs above the minimum threshold for registration, may typically want to obtain longer taxable periods to avoid making up their accounting books too often. For Australia a general six month taxable period is proposed to be electable by any taxable person with an annual turnover of less than \$250,000 (Fightback Supplementary Paper No. 5 1991 p. 8). In the EC a new simplification scheme has been proposed for businesses with an annual turnover of less than ECU200,000 (approx. AUS \$320,000).²¹ The business may file the VAT return annually by the same date as the income tax return. The credit period is not extended in the same way as advance payments of VAT must take place in installments calculated on the basis of the net amount of VAT last year.

Again, the filing of the VAT returns have to be decided pragmatically. In New Zealand there are some minor concessions to NPOs; in Canada there is a simplified Special Quick Method for filing VAT returns. Probably, for many taxable NPOs the method proposed for the EC (and which shall apply to SMBs and NPOs in general), may be of interest. If they have some income tax liability, an income tax

21 COM(86) 444, see Terra and Kajus 1991 p. 1041-1042.

return has to be filed. Being able to fulfill these two requirements at the same time, may make it more easy and less costly to use professionals who are otherwise not engaged by the organisation.

6.6 Combinations of taxable and exempt services

6.6.1 Allocation problems

Many NPOs may have special problems in computing their net tax because they both provide exempt supplies without deductibility for input tax, and taxable and zero-rated supplies against which the input tax may be deducted. To make objectively correct allocations of the input tax on "combined" goods and services concerning both the exempt and the taxable business, are not possible. Under the Coalition's proposal, such allocation problems will typically arise when charities and religious organisations supply services which compete with ordinary businesses and therefore are to be taxed, or when educational institutions provide taxable food, beverages or transport to students (Fightback Supplementary Paper No. 5 p. 24 and 15).

Rules should be provided for that are easy to handle, even though the results may be somewhat rough.

The New Zealand legislation allows a NPO to take a one-off adjustment for taxable supplies for assets the cost of which is less than \$10,000. Where the exempt supplies are only a small proportion of the total supplies (five pct.), the registered person is not required to make an adjustment for the deemed supply of the goods and services (Barrand 1991 p. 10-11). In Canada, the Special Quick Method for qualifying NPOs allows a full claim of input taxes on purchases of real and capital property over CAN \$10,000 when the property is used primarily for taxable activities. For other purchases a 50 per cent rebate may be claimed without any separation between purchases for taxable and exempt activities. In addition, organisations qualifying for this method only has to remit five pct. of the seven per cent output tax.

None of these methods would satisfy any objective theory. They express a need to find a practical solution to a problem of allocation that easily may require considerable administrative and compliance costs.

6.6.2 Consistent taxation or double taxation?

In some situations a NPO which is partly exempt, may be subject to a taxation which may appear consistent within the perspective of the VAT system, but from a more practical point of view may seem to involve some kind of double taxation. The NPO may for example wish to build a new building for activities which are exempt (not zero-rated). To finance this building the NPO involves itself in the selling of taxable goods and services. This may e.g. be the consequence of the Coalition's proposal that charities should charge output taxes when rendering supplies in competition with ordinary business. Because the building concerns non-taxable activities, the input VAT on the house may not be deductible against the output VAT on the sales.

One may argue that output tax on taxable supplies to finance non-taxable purchases should be netted against the input tax on such purchases. Such a rule might appear to be a concession to NPOs as other businesses will have to separate clearly between exempt and non-exempt activities. On the other hand, the tax consequences may be seem unreasonable, and the problem especially relevant to NPOs. In numbers: The building costs 1,000,000 exclusive VAT and 1,150,000 inclusive VAT. If the input tax is non-deductible, the NPO has reached a turnover of 1,322,500 inclusive VAT. The total VAT burden will be 322.500, if we take it, as may often be the case concerning the supply of goods and services from NPOs, that the tax is not deductible for the customer of the NPO. One approach to such a problem may be to allow certain NPOs a rebate of e.g. 50 per cent of VAT paid on purchases used in exempt activites like under the Canadian system mentioned supra.

7. GIFTS AND VOLUNTARY SERVICES

7.1 VAT: Contractual considerations

VAT is normally a tax on supplies of goods and services against a consideration.

For NPOs, this leads to different questions which may be divided into two groups:

- (i) How should donations to the organisation be treated?
- (ii) Should voluntary supplies by the organisation be taxable?

7.2 Donations to the organisation

7.2.1 Should donations be taxed?

Making a distinction between sales and donations is a problem specifically concerning NPOs even though ordinary business may receive government subsidies. Nevertheless, it is not a question of granting an exemption that puts ordinary business operations at a disadvantage. For instance, financing a corporation through equity from shareholders is not taxable. The Coalition's proposal does not seem to discuss this type of questions directly. The zero-rating of medical and educational services and charities may, however, be one way of assuring that donations like public subsidies do not result in taxation (see Fightback 1991 p. 74-76). Also, as mentioned below, the proposed exemption for sales of donated goods by NPOs may be understood as a hedge towards taxing donations (Fightback Supplementary Paper No. 5 1991 p. 20-21).

Unconditional donations to an NPO should not appear to raise any specific questions. If the "donation" in fact is a payment for services or goods, it should be treated as such. In New Zealand, "the test devised to distinguish between 'real' and 'contractual' donations is whether the person making the payment, or an associated person, receives a direct identifiable valuable benefit in the form of a supply of goods and services" (Barrand 1991 p. 5-6).

Tax expenditure analysts have reached the opposite conclusion: "Contributions should be included in the tax base because the donor, by making a contribution, acquires services the value of which either is then donated to the beneficiaries of the charitable organization or, as in the case of church, consumed by the donor as such" (Surrey and McDaniel 1985 p.93). For administrative reasons the argument concludes that the tax should be paid by the organisation. This way of reasoning seems more like an illustrative example of the all-inclusive approach by some tax expenditure analysts, than as a representative position taken in the VAT literature.

The conclusion must be that donations are not consumption or an appropriate object of VAT. The difficult question is, however, how to avoid taxing them in a way which does not presuppose too complicated and costly rules. Problems may arise whether the donation is supplied in cash or in kind.

7.2.2 Defining the donative element

Often donations may be solicited through selling different types of tokens with a symbolic value. Then, there should be guidelines for defining when this is a donation, and to what extent. In Norway, the payment is treated as a donation if the amount is at least six times the original cost to the NPO. The common sales value of the object, defined as three times its cost, is treated as a taxable sale. This rule makes for unnecessary complications, but should be related to another exemption for sales from NPOs at less than NOK 50 per item.

NPOs and especially charities make use of many special activities to raise money, e.g. fund-raising dinners, where donations and the supply of taxable goods are combined. Again, a practical solution has to be devised. One alternative may be to see the whole amount as a donation if it for at least 75/80 per cent or more may be regarded as such. Another approach may be, like in Norway for goods, to tax only the sales value of the good if the donative element is at least e.g. six times the cost price. A less schematic and perhaps more "correct", but more demanding approach, is the rule that seems to have been chosen in Canada for charities. Output VAT is charged on the actual portion of the price that refers to the taxable good.

The sale of advertising etc. is normally taxable. It may be hard to draw the line between taxable sales of advertising services and the tax free receipts of donations. The unclear term sponsorship is often used in everyday language. This word may include both donations and advertising. One rule may be that any payments for direct advertising are taxable. As advertising in the magazines of NPOs etc. often may entail a donative element, such a rigid rule undoubtedly may result in some taxation of donations. On the other hand, however, the advertiser will often be able to deduct this input VAT. In Canada, one also applies a "50 per cent rule". The supply of promotional services by an NPO is not taxable if the money paid to the organisation cannot be primarily (more than 50 per cent) for the advertising service.

7.2.3 Donations of goods and services

Sometimes, a donation may be made by a taxable person in the form of a good or service that would be taxable if sold. A carpenter may e.g. assist the scouts club of his daughter in renovating their camp. If a taxable person renders such services to himself, he may be liable to pay output VAT for deemed supplies under many VAT systems. The same applies if he consumes for himself taxable goods that otherwise would be sold. If these goods are provided to a NPO free, should the provider be taxed for deemed supplies?

From a theoretical point of view, there may be no clear cut answer to these questions. One may hold that the person consumes services and goods by giving them away. This is the point of view that often will be applied if a taxable person makes gifts. On the other hand, it may be said that donations to NPOs typically represent abstaining from one's own consumption to the advantage of a common good.

In Norway, the law was changed in 1991. The decisive argument for the legislator was probably not theoretical, but practical. Since our VAT legislation was effective as of January 1 1967, the donation of services by taxable persons to NPOs should be taxed as deemed supplies. For those nearly 25 years, it has not been possible to register any such transaction being taxed even though they occur rather often. Therefore, the law in the books was changed to correspond to the law in practice. However, only services may be donated to NPOs without output tax being liable. Goods will be taxed. Again, the decisive factor was a practical consideration. A tax free status for the donation of goods might be exploited for tax evasion.

The Coalition's proposal deals with another aspect of donated goods. Sales of donated goods, such as second-hand clothing and household items, which are sold in opportunity shops and similar retail outlets, are to be exempt from GST, if the shops are run by non-profit bodies (Fightback 1991 p. 20). As private individuals will be able to sell their second-hand goods tax free, as is common under VAT-legislation, this system of tax free sales by NPOs may seem like a natural consequence. The price distortions compared to ordinary business may not be significant as these businesses will be able to claim a credit for a notional input tax when buying second-hand goods from individuals. An allowance for NPOs as proposed, should however be analysed more closely to see if it may effectively exclude ordinary businesses from competing in this area.

7.3 Voluntary supplies by the organisation

Many NPOs will render their services for free. Tax expenditure analysts have held that donations should be included in the tax, see *supra*, and therefore a charitable organisation should pay VAT on the costs of its salaries to employees. Then it would effectively pay VAT on its free services rendered to its beneficiaries (McDaniel and Surrey 1985 p. 93). This point of view does not, however, appear to be commonly held.

Another line of reasoning may be that many NPOs will fall outside the scope of the VAT because their services are rendered for free. If one wants to make zero-rating available to such organisations because they render services within health or education, one has to allow such zero-rating even though the basic premise of contractual consideration under the VAT is not satisfied. Without such a rule, one would tax more heavily - through the non-deductibility of the input tax - NPOs rendering services and goods for free than NPOs charging some smaller or bigger amount for their supplies. Such an inconsistent system may, however, appear to be the situation in New Zealand (Barrand 1991 p. 8). The Coalition's proposal appears to imply that the zero-rating will apply whether or not the educational and medical services are rendered for free or for a consideration. The point may, however, deserve some discussion.

8. SPECIAL EXEMPTIONS AND ZERO-RATINGS FOR CHARITIES AND NPOS - DIRECT EXCLUSIONS

8.1 Supplies of goods and services typically performed by NPOs.

NPOs may not only benefit from the general definition of taxable transactions and objects as discussed supra. The legislator may also provide NPOs with concessions - direct exclusions. Of course, the distinction between indirect and direct exclusions are not clear. It is more a matter of changing perspective. Now we are discussing concessions which are more related to the characteristics of the organisation. Taking the object-focus of the VAT, we shall still pay much attention to the supplies performed. However, now we are not discussing exclusions of a general nature, but concessions which should be made for certain supplies because they are typically performed by NPOs in ways which should not distort ordinary business operations.

Such concessions may be available to all NPOs or only to qualified NPOs, e.g. charities.

The motives for such concessions may vary. One basic consideration may be that as long as the VAT primarily is a "neutral" fund-raising instrument, it should not inhibit the social and humanitarian activities of entities which supplement the welfare activities of the government.²² As with any tax, negative side-effects should be avoided.

8.2 A general exclusion would create distortions

Simply to exclude all NPOs would not be feasible. If an organisation starts selling taxable goods and services, the starting point of an object-oriented VAT must be that such sales should be taxable. It may however be possible to make rules which exclude sales made in a way which is typical of NPOs and which ordinarily will not compete with normal businesses.

8.3 Exclusively on a voluntary basis

One characteristic trait of the third - NPO - sector compared to the government and the market, is that some of the work is unpaid. In Canada, supplies by charities may be VAT-exempt if all functions are performed exclusively (90 per cent or more) by volunteers.

Such a requirement may make it possible to deliver some goods and services with a "VAT-rebate" compared to ordinary small and medium sized businesses. It is, however, hard to see how this concession might threaten other business operations seriously. On the other hand, it may be a criteria that allows typical NPO-activities to be exempt. Also, it is an incentive for voluntary work and helps donations by way of unpaid work remain untaxed. Canadian experience will tell how easy it will be to monitor such a requirement for the tax authorities.

The proposed exemption by the Coalition for sales by NPOs of donated second-hand goods may perform a similar function (see section 7.2.3 above). Ordinary business will not normally receive

22 Fightback 1991 p. 74-75 is perhaps expressing the same basic concern but in more technical language of price signals and equitable tax burdens when compared to government institutions.

donated goods.

8.4 Sporadic activities

Often, NPOs will engage in different sorts of one-time or sporadic activities to finance its operations. By its very nature, sporadic supplies of services and goods usually will not represent a serious threat to ordinary business.

In Norway, there has been an unclear distinction between taxable ongoing activities, e.g. a permanent second hand shop run by an NPO, and irregular fleamarkets. Goods sold for less than NOK 50 (AUS \$10) may also be tax exempt if the sales operations are not performed on a regular basis.

The registration thresholds will contribute to excluding sporadic activities. To allow NPOs to be treated differently when they actually behave so compared to ordinary business, some exclusion may be needed for sporadic supplies of goods and services.

8.5 Supplies made to the "clients" of the organisation

The purpose of many NPOs are to serve clients who suffer from poverty, stress, physical handicaps or psychological illness. Sometimes this may be done through the sales of goods and services which would otherwise be taxable, e.g. food or wheel chairs. The price may include the purchase price for the goods and some or all of the administrative overhead. In Canada, food sold at a food kitchen will be exempt under a "relief of poverty, suffering and disease" exemption.

In many instances, an exemption will not matter so much as the overhead is small. Only zero-rating would really eliminate the tax burden for the clients in the last instance.

Zero-rating the sale of e.g. medical equipment or other more expensive, but necessary goods, when performed by charities, might, however greatly distort competition. Only organisations qualifying might be able to sell the goods in question. Therefore, it is open to doubt what sorts of sale outside the "soup-kitchen" and "short-term accommodation" variety should qualify.

8.6 Loss operations - business test

A NPO may be supplying goods and services at a price covering direct costs. Under Canadian VAT legislation such sales at nominal charges will be exempt from output VAT. Accordingly, the input tax should also be treated as outside the VAT-system. Then the organisation has to pay a definite non-deductible input tax on its purchases. The exemption "at the other end" does not mean very much since the disallowed input VAT will correspond rather closely to the output VAT.

Loss operations run by NPOs may benefit from registering. As the organisation sells at a loss, it will

benefit from enlisting as a taxable person. Input costs and taxes are higher than the sales price and the output tax. In reality, the organisation here obtains a deduction for gifts it provides itself. As has been stated above, a profit motive or actual profitable operations are not a precondition to register as taxable person. On the other hand, supplies of goods and services at a definite and deliberate loss, can hardly qualify as taxable operations. To avoid subsidising the deliberate loss operations, the VAT-legislation would have to introduce some kind of business test, unless one really wants to eliminate all tax on the goods and services in question.

9. EXCLUSIONS OR COMPENSATING GRANTS?

9.1 No definite theory of the incidence of the VAT

There is no clear cut answer to the question as to who is the real taxpayer of VAT. "No conclusive answer can be found" in the literature (TEI 1992 p. 26). The price-elasticity and the possibility of substituting the taxable good or service may have great impact on who bears the tax and to what extent: The seller or the purchaser (Melz 1991 p. 45-51).

If e.g. a club run as an NPO, but taxable, has to add 15 per cent on goods and services supplied, it is a formal argument that no "VAT is borne by the club" because the club only adds the output tax to its bills (Fightback Supplementary Paper No. 5 1991 p. 24). Nobody really knows the answer to the question how the real tax burden is shared when a VAT is introduced. To presuppose 100 per cent incidence may not be very realistic. Therefore, the Coalition's analysis of its proposal to include NPOs in general (exclusive of charities) under the GST, may not seem very informative. There is no reason to believe that e.g. club memberships and sports training has no substitutes and a price elasticity shifting the entire output tax over to the client. Such assumptions have, however, to be made in order to support the conclusion analysing the effect of output VAT for a soccer club, that:

"So it can be seen that all the GST is passed on through the buying and selling chain and only the final consumers, in this case the club members who pay the subscriptions, actually pay the tax and cannot claim it back." (Fightback Supplementary Paper No. 5 1991 p. 25).

Such a simplified analysis without any clear support in the VAT literature, may hold the government back from taking the responsibility of the effects on NPOs from introducing a VAT.

9.2 The absolutism of administrative considerations

When a new VAT is introduced, most NPOs even if exempt or zero-rated for part of their supplies, will either meet some input tax which is not deductible or have to charge an extra output tax which may not be totally rolled over on their clients. This extra tax on NPOs may, to a certain extent, be regarded as some kind of side-effect of introducing a VAT. The purpose of the VAT is quite simply to raise money for the public purse in a more efficient and less costly manner than e.g. income tax

systems.

Many legislators may agree to the treatment of NPOs as tax exempt under many income tax systems. The fact that this treatment can be wholly or partly changed due to the implementing of a VAT, may not be due to a deliberate policy shift regarding NPOs. It will often be more appropriately explained as a side-effect of policy-making pursuing other objectives.

Many administrative reasons point to the "ideal" VAT with nearly no exclusions. Even though in practice many legislators have made some concessions available to NPOs, it has to be accepted that due to simplifying- and cost-considerations many well-motivated exclusions may not be made available to the organisations.

As administrative considerations are very basic for running a smooth VAT system, they may sometimes acquire the character of rather absolute principles. This absolutism should not be accepted, and at least not be allowed to acquire the atmosphere of some objective principles of taxation. Then it may be harder to point out that NPOs are not necessarily taxed because they should be taxed as such, but because one is unable to find practical ways to exclude them.

There is no consistent and widely accepted theory regarding the treatment of NPOs under the VAT. Therefore, the representatives of NPOs are quite free to propose how the VAT should be adjusted to avoid interfering in the way NPOs are fulfilling their missions. To put forward proposals it will be important to have a keen understanding of the VAT. If the proposed solution is practiced - without too many administrative problems - in other countries, this may be a relevant argument.

9.3 Extra tax burden

When no exclusions seem to be acceptable, representatives of NPOs might be wise to try to calculate as objectively as possible the added tax burden for the organisations. Such calculations may provide the background for negotiations about compensating the NPOs involved.

In Australia, zero-rating seems to have been favored in many submissions from charities to the government. Increased government subsidies have been seen as potentially binding the organisations into accepting government social welfare policies with which they might disagree (Fightback 1991 p. 76). In general it may be said that subsidies are more vulnerable to budget cuts etc. than zero-ratings firmly engraved in permanent VAT-legislation.

Within the EC, however, it may seem like some NPOs have found an alternative rebate system to be their best choice.²³ When it comes to relieving the organisation and one's clients of the input tax on e.g. wheel chairs, the rebate approach may seem defaitistic, but realistic. In the EC, however, the

23 See e.g. the unpublished report of the conference VAT and Charities in the European Community, Brussels October 20/21 sponsored by the Charities' Tax Reform Group.

pressure towards harmonisation and simplification may be especially hard because the harmonised VAT-basis also serves as the basis for calculating parts of the annual membership contributions.

Both within the income tax and the VAT the trends towards more general rules seem to be rather universal. Therefore, the case for exemptions etc. may seem especially demanding. The Coalition's proposal for a GST may seem especially hard on NPOs which are not charities and not supplying qualifying educational and health services. For such organisations, if concessions in the VAT-legislation do not seem feasible, it may be relevant to ask the question why they are taxed. May it be regarded as a side-effect of letting the VAT money machine to run more smoothly, or is a matter of more principled policy. In the first instance, a strategy for refunds may be an alternative.

9.4 A rebate system - the concept of net transference

Settling for a rebate system will necessarily make the organisations more dependent on the government. Also when applying exemptions, this may be the case, even though such arrangements usually will be more stable. Any tax system which may tax or exempt NPOs, seem to have this inherent side effect of increasing their dependency on the government.

Introducing a VAT may make for more sophisticated ways of calculating the cash streams between the organisations and the government. When there is an estimate of the VAT actually paid, this may be compared to the subsidies, grants etc. received from the government. Only the net amount after the VAT has been deducted, may be seen as a net subsidy or net transference. This concept of net transference may reduce the legitimacy of the government in being very demanding about how NPOs etc. should be run to qualify for subsidies etc.

9.5 From exclusions to "tax subsidies"?

As any change, introducing a VAT may be demanding for those concerned. It takes time to become familiar with new tax provisions and understand the possible consequences. The period of preparing the law may however represent a unique chance in having the government accept necessary adjustments of the rules as they relate to NPOs. Any change is also a more or less open situation.

After a proposed VAT has been introduced, it may take on a life on its own which makes the acceptance of exclusions harder to accept. Also, it may be more difficult to point out that exclusions from taxation are not necessarily subsidies, but an avoidance of a taxation which basically may not have been intended and which may have consequences that no one really wishes. The moment a tax is introduced, it may seem paradoxical to label those who may not be taxed as the recipients of subsidies. After some time, this may change.

One of the Coalition's reasons for zero-rating charities was, as we have seen, the wish of such institutions to avoid the dependency on subsidies. It may, however, be harder to have this line of reasoning accepted after a VAT has been effective for some time. Then, any exclusion may be

labelled as an indirect subsidy or tax expenditure. Consequently, introducing a new tax like a VAT is not a static event. Any tax is a dynamic and psychological process. After some time the premises of a new tax may be taken as much more granted.

This paper has argued that in the VAT, there is a tendency towards generalisation and focusing on the transactions, not on the subjects. Probably, once excluded does not mean for ever excluded. Organisations being excluded will need to have a strategy for upholding such concessions in the future. In the short term lobbying etc. may help; in the long run a deeper understanding of the VAT, both its principles and technical aspects, are indispensable.

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